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MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

QUARTER ENDED SEPTEMBER 30, 1989

PLEASE RETURN

CASE RETURN

MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

QUARTER ENDED SEPTEMBER 30, 1989

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APPOINTIVE OFFICIALS

Charles A. Brooke, Lottery Director

L. John Onstad, Lottery Assistant Director for Security

LOTTERY COMMISSION

		TERM EXPIRES
Spence Hegstad, Chairman	Dillon	January 1, 1990
Pat DeVries	Polson	January 1, 1991
Jim Moore	Bozeman	January 1, 1990
Bill Ware	Helena	January 1, 1993
Becky Erickson	Glasgow	January 1, 1993

LOTTERY LIAISON COMMITTEE

Senator Hubert Abrams	Wibaux
Senator Ethel Harding	Polson
Representative Linda Nelson	Medicine Lake
Representative Norman Wallin	Bozeman

REPORT DISTRIBUTION

According to Section 23-5-1007(7), MCA, copies of this report must be distributed to the following individuals.

Stan Stephens, Governor

Dave Ashley, Director, Department of Administration

Scott Seacat, Legislative Auditor

Jack Galt, President of the Senate

John Vincent, Speaker of the House

The law also states "the President of the Senate and the Speaker of the House will determine the report distribution to each member of the appropriate committee of each house of the legislature". The President of the Senate and the Speaker of the House requested this report be distributed to the Revenue Oversight Committee. In addition, the Speaker of the House requested this report be distributed to the House Business and Economic Development Committee.

Members of the Revenue Oversight Committee include:

Senators	Representatives
Bill Norman, Chairman	Susan Good, Vice Chairman
Bruce Crippen	Dan Harrington
Dorothy Eck	Robert Hoffman
Thomas Hager	Jim Patterson
Joe Mazurek	Ted Schye
Robert Brown	Robert Ream

The House Business and Economic Development Committee members include:

Representatives	
Bob Pavlovich, Chairman	Gene DeMars, Vice Chairman
Fred Thomas	Bob Bachini
William Glaser	Thomas Nelson
Stella Jean Hansen	Lloyd "Mac" McCormick
Bruce Simon	Norm Wallin
Clyde Smith	Rob Blotkamp
John Johnson	Vernon Keller
Tom Kilpatrick	Don Stappler

Lottery Montana

December 8, 1989

Stan Stephens
Governor

Charles A. Brooke
Director

Montana Lottery Commission Members

Spencer Hegstad
Chairman, Dillon

William Ware
Helena

Pat DeVries
Polson

Jim Moore
Bozeman

Becky Erickson
Glasgow

Montana Lottery Commission:

The first quarter of fiscal year 1990 marked a turning point for the Montana Lottery. For the first time in the Lottery's history, two consecutive quarters of increased revenues were recorded. This turnaround can be attributed to a number of things. In July the Lottery offered its first game at a higher prize payout. "Centennial Gold Rush", a 55% prize payout game, sold out to the retailers on August 9. The fourteenth Lottery game, "Pickup Plenty", went on sale offering a merchandise prize to players, another first for the Lottery. These two unique games, coupled with an aggressive advertising campaign, resulted in a transfer to the Office of Public Instruction of nearly $700,000.

To top off the quarter, the Lottery contracted with Control Data Corporation to provide an on-line game to Montana players. This product will complement the instant ticket games and should provide additional profits to transfer to the Office of Public Instruction and Montana's public schools.

Charles A. Brooke,
Director

Montana Lottery, 2525 N. Montana, Helena, MT 59601-0542. (406) 444-LUCK. FAX (406) 444-5830

MONTANA LOTTERY
BALANCE SHEET
SEPTEMBER 30, 1989

ASSETS	(Unaudited)
Cash	$ 692,612
Receivables (Net)	1,101,421
Inventories	130,716
Equipment	736,671
Other Fixed Assets	4,093
Accumulated Depreciation	(270,422)
Intangible Assets	541,844
Other Assets	109,212
TOTAL ASSETS	$ 3,046,147

LIABILITIES AND FUND EQUITY	
Liabilities:	
Accounts Payable and Accruals	$ 255,877
Lottery Prizes Payable	1,625,364
Due to Other Funds (Note 2)	684,572
Installment Purchase/Lease Payable	342,241
Compensated Absences Payable (Note 1)	82,626
Allowance for Ticket Returns	55,467
	$ 3,046,147
FUND EQUITY:	
Retained Earnings Unreserved	-0-
Total Fund Equity	-0-
TOTAL LIABILITIES AND FUND EQUITY	$ 3,046,147

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
PERIODS ENDED SEPTEMBER 30, 1989

	Quarter Ended September 30, 1989 (Unaudited)
OPERATING REVENUES:	
Charges for Service	
Net lottery ticket revenue	$ 3,580,299
Sold Instabucks (net)	4,891
License and permits	900
Total Operating Revenues	$ 3,586,090
Prizes and Commissions	
Prize expense	(1,928,570)
Retailer commission	(252,601)
Net Operating Revenue	$ 1,404,919
OPERATING EXPENSES:	
Amortization	$ 51,187
Personal Services	192,349
Contractual Services	38,806
Cost of tickets sold	136,190
Audit Fees	7,318
Supplies and Materials	14,310
Depreciation	28,716
Utilities and Rent	23,058
Communications	17,622
Advertising	166,048
Travel	5,219
Repairs and Maintenance	18,759
Management Service Fee	20,471
Other	5,915
Total Operating Expense	$ 725,969
Operating Income	$ 678,951
NONOPERATING REVENUES (EXPENSES)	
Interest Expense	(172)
Total Nonoperating Revenues (Expense)	(172)
Income before Operating Transfers	678,778
Operating Transfers In (Out)	(678,749)
NET INCOME (LOSS)	$ 29
Retained Earnings, Beginning of Period (Note 5)	(29)
RETAINED EARNINGS, END OF PERIOD	-0-

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
Notes to the Financial Statements (Unaudited)
SEPTEMBER 30, 1989

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-5-1001, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated by a five member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer regional lottery games and prepare financial reports.

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund.

The Montana Lottery is classified as an Enterprise Fund of the governmental Proprietary Fund Type. Enterprise Funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Receivables. Receivables totalling $1,101,421 represent amounts owing the Lottery for purchased tickets. An allowance for doubtful accounts is usually based on historical perspective. Because of immaterial uncollectible account balances, an allowance for doubtful accounts has not been established.

Receivables include a $13,499 adjustment in retailer commissions related to estimated ticket returns.

Inventories. Inventories consist of merchandise, Instabuck and supplies inventories. Merchandise inventory includes lottery tickets valued at $99,632 stored in the warehouse and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold when sold. After game end and awaiting disposal, unsold tickets are charged to cost of tickets sold.

Merchandise inventory includes a $7,911 adjustment related to estimated ticket returns.

Supplies inventories include paper supplies, ticket dispensers, premiums and point-of-sale materials having a value of $5,000 or more. At quarter end, supplies inventories totaled $31,084. These inventories are also recorded at cost using the specific identification method.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's payable for compensated balances is detailed below.

Balance June 30, 1989	Net Leave Earned Used	Balance September 30, 1989
$74,789	$7,837	$82,626

Allowance for Ticket Returns. This allowance represents a liability as of September 30, 1989 for estimated ticket returns. The allowance for ticket returns was reduced by $232,497. This is an estimate based, partially, on actual returns received after the end of the quarter. Conversely,

ticket revenue has been increased by approximately $232,497 for the quarter ended September 30, 1989. Prize expense has been increased by approximately $103,239. Commissions and cost of goods sold have also been increased for expenses associated with this change in allowance.

Revenue Recognition. Lottery ticket sales are recorded as revenue based on ticket deliveries to the retailers. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales have been increased by an allowance for estimated ticket returns.

Free Tickets. The Montana Lottery's instant games award free tickets as prizes. Net lottery ticket revenue does not include the value of free tickets given away and free plays won. The face value of these free tickets distributed approximated $673,855 for the quarter ended September 30, 1989.

Instabucks. Instabucks are a Lottery coupon good, upon redemption, for a lottery ticket. Instabucks, used to stimulate lottery ticket sales, are usually given away for promotions, retailer clerk incentive programs, and advertising trade-outs. The lottery tickets distributed resulting from Instabuck redemptions are reflected as a reduction in revenue. The related prize expense and ticket cost are reclassified as an advertising expense. For the quarter ended September 30, 1989, Instabuck redemptions resulted in a revenue reduction of $55,552 and a prize expense reclassification of $30,527.

Instabucks Sold. The Montana Lottery entered into an agreement with the Big Sky Country GMC Truck Dealers Association during the first quarter of fiscal year 1990 for the sale of 5,000 Instabucks to be used by the members of the association for promotional purposes during the "Pickup Plenty" instant ticket game. The sale and redemption of these Instabucks resulted in additional revenue to the Montana Lottery of $4,891.

Prizes. Expenses for instant prizes are recorded based on the predetermined prize structure for each game. No prize expense is recorded for free tickets distributed.

Commissions. Retailers receive a five percent commission on tickets or chances sold. Commission expense is recorded based on the face value of tickets delivered to the retailers.

Retailers can receive bonus commissions on tickets sold based on incremental sales of instant tickets. During the

quarter ended September 30, 1989, retailers earned bonus commissions totaling $48,741 which were paid in October, 1989.

Amortization. The Instant Lottery System (ILS) software, classified as an intangible asset, is being amortized over a period of five years using the straight line method. The Media Drop-In Productions, Inc. contract for the use of ten lottery advertisements, is also classified as an intangible asset. This contract is being amortized over a period of 3 years using the straight line method.

2. DUE TO OTHER FUNDS

The account "Due to Other Funds" totalling $684,572 reflects the $678,749 payable to the State Superintendent of Public Instruction and $5,823 due to other state agencies for goods and services provided through September 30, 1989. An estimated transfer for the quarter ended September 30, 1989 of $600,000 was paid on October 2, 1989 and the remaining $78,749 will be paid during the quarter ended December 31, 1989.

3. PAID PRIZES

Section 23-5-1027 MCA states "A minimum of 45% of the money paid for tickets or chances must be paid as prize money".

For the quarter ended September 30, 1989, the prize expense of $1,928,570 reflects 53.87% of net ticket revenues totalling $3,580,299. From July 1, 1989 through September 30, 1989 prizes paid are detailed as follows:

High-tier	$ 376,670
Low-tier	1,070,201
Big Spin	392,000
	$1,838,871

High-tier prizes reflect prizes greater than $25 paid through Lottery headquarters. Low-tier prizes of $25 or less are paid by the retailer or Lottery headquarters.

4. TRANSFER TO STATE SUPERINTENDENT OF PUBLIC INSTRUCTION

Section 23-5-1027, MCA states "that part of all gross revenue not used for payment of prizes, commissions, and operating expenses is net revenue and must be paid quarterly

from the enterprise fund to the State Superintendent of Public Instruction for distribution as equalization aid to the public schools of Montana..." For the quarter ended September 30, 1989, the net revenue amounted to $678,749. An estimated transfer for the quarter ended September 30, 1989 of $600,000 was paid on October 2, 1989 and the remaining $78,749 will be paid during the quarter ended December 31, 1989.

5. DEFICIT RETAINED EARNINGS

According to the law, the Lottery's net revenue must be transferred quarterly to the State Superintendent of Public Instruction. This transfer should result in a zero retained earnings balance. Because of recording a fiscal year 1988-1989 expenditure after calculation of the transfer for the quarter ending June 30, 1989, the beginning retained earnings balance is (29) rather than zero.

6. GAMES

Currently, the Montana Lottery games are instant ticket games. These games provide players the opportunity to win instantly by scratching a latex covering to reveal a prize. Players also have another chance to win by submitting five non-winning tickets or their equivalent for the Big Spin drawing.

7. GAMING SUPPLIER CONTRACTS

Tickets. On March 9, 1987, the Montana Lottery signed a one year contract with Scientific Games, Inc. to purchase lottery tickets. Under that contract, each instant ticket game consisted of 4,800,000 tickets or "other quantity as agreed by the parties."

This contract was extended until March 9, 1989 by letter dated February 23, 1988 and amended on May 5, 1988. The contract amendments address certain ticket specifications, price, and quantity. The amended minimum order quantity is 4,080,000 tickets.

On January 5, 1989, the contract was extended until March 9, 1990. The contract extension amended ticket prize and quantity. The amended minimum order quantity is 2,160,000.

The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure. The contract requires payment within 30 days of ticket receipt.

Scientific Games, Inc., as the vendor, delivered a $776,104 performance bond covering the contract term. The Company also provided an errors and omissions policy covering an ultimate net loss of $5,000,000.

This contract may be terminated when termination is in the best interest of the Lottery with proper notification to Scientific Games, Inc.

Computer Hardware and Software. The Lottery contracted with Scientific Games, Inc. on February 25, 1987, to purchase a used Stratus computer. The computer hardware and software cost $381,243. This contract also covered the acquisition of an Uninterruptable Power Supply (UPS) system for $40,551. The UPS system protects the computer against electrical power surges and failures.

The Lottery signed a separate agreement with Stratus Computer, Inc. on June 2, 1987, for maintenance of the Stratus computer hardware and software. Monthly maintenance totals $4,433.

On July 28, 1987, the Lottery signed a second agreement with Stratus Computer, Inc. regarding the Stratus software license. Under this contract, Stratus Computer, Inc. grants the Lottery a "nonexclusive, nontransferable license" to use the software of the Stratus computer. The proprietary rights and title of the software remain with Stratus Computer, Inc.

Lottery Software. On February 25, 1987, the Lottery agreed to purchase the Instant Lottery System (ILS) software package for $840,400. This agreement provides the Lottery a "perpetual, nonexclusive, nontransferable license to use the software solely for the Lottery's own use". The contract allows the Lottery to make 36 monthly payments of $23,344.44 with no interest. The first payment was due June, 1987.

Under the Extension and Second Amendment of Instant Ticket Contract dated January 5, 1989, these monthly payments were reduced to $11,672.22 commencing with the November 1988 payment. Upon expiration or termination of the Instant Ticket Contract the payments will be reinstated to $23,344.44 until the balance is paid in full.

8. PRIZE ANNUITIES

During fiscal year 1989, the Montana Lottery awarded four Big Spin Jackpot prizes totalling $5,000,000. The Lottery made the initial payments to the winners in the amount of

$253,088 and on September 26, 1988, the Montana Lottery awarded annuities in the amount of $2,350,180 to Western National Life. Through these annuities, Western National Life makes the remaining payments to the Big Spin Jackpot winners. As of September 30, 1989, the contingent liability for future prize payments funded through the purchase of annuities was $4,493,824.

9. SUBSEQUENT EVENTS

On October 3, 1989, the Montana Lottery contracted with Control Data Corporation to provide an on-line game to the State of Montana. The Montana Lottery was admitted to the Multi-State Lottery Association on November 1, 1989 to join in the Lotto*America game along with 8 other states. Sales began on November 9, 1989.

OTHER

INFORMATION

MONTANA LOTTERY
SUMMARY OF FINANCIAL DISTRIBUTION
(UNAUDITED)
QUARTER ENDED SEPTEMBER 30, 1989

COMMISSIONS - Section 23-5-1016(10), MCA provides retailers a 5 commission on tickets or chances sold. The commission on tickets sold to the retailer gives the retailer $15 per book of 300 tickets. The 5% commission of $203,860 for the quarter September 30, 1989, is based on gross lottery ticket sales of $4,077,205. In addition retailers earned bonus commissions on tickets or chances sold of $48,741.

OPERATING EXPENSES - The Lottery, according to Section 23-5-1007(9), MCA, must prepare quarterly and annual reports on all aspects of the operation of the state lottery, including gross revenue and operating expenses. Gross revenue includes net lottery ticket revenue and license fees. While retailer commissions, by law, are not considered an operating expense, interest expense is considered an operating expense for this purpose. Total operating expenses for the quarter ended September 30, 1989, using the accrual basis of accounting, is as follows:

	Quarter ended September 30, 1989 (Unaudited)
Net lottery ticket revenue	$ 3,580,299
Sold Instabucks	4,891
License and permits	900
Total Gross Revenue	$ 3,586,090
Operating expenses	725,969
Interest expense	172
Total Operating Expense	$ 726,141

STATE SUPERINTENDENT OF PUBLIC INSTRUCTION TRANSFER - The funds transferred to the State Superintendent of Public Instruction, by law, are not based on a percentage of revenue. The distribution is based on a definition of net revenue. Net revenue is that part of all gross revenue not used for the payment of prizes, commissions, and operating expenses. Net revenue for the quarter ended September 30, 1989, is detailed below:

	Quarter Ended September 30, 1989 (Unaudited)
Income before Operating Transfers	$ 678,778
Retained Earnings, Beginning of Period	(29)
Net Revenue Transferred to State Superintendent of Public Instruction	$ 678,749

PRIZES - Section 23-5-1027(1a), MCA, states "A minimum of 45% of the money paid for tickets or chances must be paid out as prize money..."

Prize expense is recorded based on the predetermined prize structure percentage for each game. For the quarter ended September 30, 1989, the prize expense of $1,928,570 is 53.87% of the net Lottery revenue of $3,580,299.

When recording the prize expense, a corresponding liability for high-tier and Big Spin prizes is also recorded. The relationship between prize expense, prizes paid and the change within prize liability is illustrated below:

July 1 through September 30, 1989		Percent of Net Lottery Ticket Revenue (Unaudited)
Prizes paid	1,838,871	51.36
Instabucks	(30,527)	(.85)
Increase (decrease) in prize liability	120,221	3.36
Prize expense	$1,928,570	53.87%